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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1939

No. 752

FRANZ J. BORCHARD AND FRIEDA W. BORCHARD,
Petitioners,

vs.

CALIFORNIA BANK, A BANKING CORPORATION, AND CALIFORNIA TRUST COMPANY, A CORPORATION.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT.

REPLY BRIEF FOR PETITIONERS.

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Subject Index.

	Page
Question involved	1
Argument	2
Provisions of Section 75(s) mandatory	3
Bartels case	5
Cannot surrender jurisdiction	5
Section 75(s)	6
Has equity in his farm	7
Conclusion	9

Table of Cases Cited.

Adair v. *Bank of America National Trust & Savings Association*, 303 U. S. 350	8
Bradford v. *Fahey*, 76 F. (2d) 628	6
Chicago, Rock Island & Pacific Ry. Co., In re, 72 F. (2d) 443	4
First National Bank & Trust Co. v. *Beach*, 301 U. S. 435	8
Gray v. *Union Joint Stock Land Bank*, Nos. 365-367, October Term, 1939	9
John Hancock Mutual Life Ins. Co. v. *Bartels*, 60 Sup. Ct. 221	1
Lines, In re, C. C. H. 51, 605	4
Louisville Joint Stock Land Bank v. *Radford*, 295 U. S. 555	2
Louisville Joint Stock Land Bank v. *Radford*, 8 Fed. Supp. 489	6
McIntyre, In re, 23 Fed. Supp. 342	4
Morrison v. *Federal Land Bank of Louisville*, Nos. 412 and 413, October Term, 1939	9
Wright v. *Union Central Life*, 304 U. S. 502	8

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CALIFORNIA BANK, A BANKING CORPORATION, AND CALIFORNIA TRUST COMPANY, A CORPORATION,
Respondents.

REPLY BRIEF FOR PETITIONERS.

Question Involved.

The question involved is whether under Section 75 (s) of the Bankruptcy Act the District Court may, upon motion of the creditor, terminate the stay and permit foreclosure of the mortgage on the farmer-debtor's farm because it, the court, feels that the farmer-debtor had an opportunity to effect rehabilitation and has been unable to do so. In other words, may the lower court with impunity ignore the procedure laid down by an Act of Congress and follow a procedure not only in violation of the plain language of the Act but contrary to the decision of the Supreme Court of the United States in the *Bartels* case, 60 S. Ct. 221?

Argument.

In the case at bar the petitioners' original petition was dismissed on June 26, 1935, because the Supreme Court of the United States held Section 75 (s) unconstitutional in the *Radford* case, 295 U. S. 555. After the reenactment of Section 75 (s) the lower court, on September 20, 1935, reinstated the petitioners' petition. On October 18, 1935, the petitioners filed their petition for the appointment of appraisers.

Thereafter, by stipulations and mutual consent of petitioners and the respondent bank all proceedings were stayed until November 10, 1938, when the bank asked for leave to sell under its trust deed. By virtue of these stipulations the petitioners paid the following amounts to the respondent: May 27, 1936—$3,900; June 10, 1937—$2,494.83; December 20, 1937—$3,556.64; and March 7, 1938—$3,450 or a total of $13,401.47 (See R. 21 to 33 inclusive). These stipulations provide "that nothing herein shall prejudice or jeopardize the rights of the debtors" (R. bottom of page 25).

The Circuit Court of Appeals of the Ninth Circuit in its opinion confirming the lower court says: "Thereafter with the understanding that they would be without prejudice to the rights of either party various stipulations were entered into by appellants and appellee as to the administration of the proceedings, and operations of the farming property, and the disbursements and use of the proceeds of the crops in 1936, 1937 and 1938" (From the court's opinion, R. 187).

The fact that by these mutual agreements and stipulations the proceedings under Section 75 were held in a *status quo* has nothing to do with the question of rehabilitation under Section 75 (s), nor did it affect the right of the farmer-debtor to ask the further protection of the

provisions of Section 75 (s) when the bank terminated these stipulations and asked for leave to sell.

Provisions Mandatory.

The provisions of Section 75 (s) *are mandatory*, and while the *stay of three years is not absolute, the statute itself provides the exception. No court has authority* to sell the debtor's property *because his liabilities exceed his assets*, or because, it the court, concludes that the debtor cannot be rehabilitated. *To do so is reading something into the statute that is not there.* It is judicial legislation.

> "Section 75 (s) (2) *When the conditions set forth in this section have been complied with, the court shall stay all judicial or official proceedings* in any court, or under the direction of any official, against the debtor or any of his property *for a period of three years. During such three years the debtor shall be permitted to retain possession* of all or any part of his property, in the custody and under the supervision and control of the court, *provided he pays a reasonable rental* semi-annually for that part of the property of which he retains possession. * * * The court, in its discretion, if it deems it necessary to protect the creditors from loss by the estate, and/or to conserve the security, *may order sold any unexempt perishable property of the debtor, or any unexempt personal property not reasonably necessary for the farming operations* of the debtor, such sale to be had at private or public sale, and *may*, in addition to the rental, *require payments on the principal due and owing by the debtor* to the secured or unsecured creditors, as their interests may appear, in accordance with the provisions of this Act, and may require such payments to be made quarterly, semi-annually or annually, not inconsistent with the protection of the rights of the creditors, and *the debtor's ability to pay, with a view to his financial rehabilitation.*"

In re Chicago, Rock Island & Pacific Ry. Co. (7 C. C. A.), 72 F. (2d) 443, the court said:

> "Congress having the express authority to enact legislation on the subject matter of bankruptcy, was the sole judge of the means and their appropriateness to the purpose of the legislation so long as said means did no violence to the Constitution.
>
> "The sale contemplated by Section 75 (s) 3 is *authorized only at the end of the moratorium period.* A petition to dismiss the proceeding, and another to dissolve the injunction against the foreclosure of the mortgage, have been denied by one of my colleagues; and the section of the Act under which the proceeding was instituted has provided no distinct method of disclaimer on the part of the court." *In re McIntyre*, 23 Fed. Supp. 342.
>
> "Section 75 (s) (3) fails to disclose any authority in this court to dismiss this proceeding or to strike from the schedule the lands involved, were it established that the debtor will be unable to refinance himself within three years." *In re Lines*, C. C. H. 51, 605.

The Act specifically *states* that an appraisal is to be made of all of the farmer's property "*at its then fair and reasonable market value.*" That is to say that the reasonable market value *fixes the debtor's assets and also the limit* of his liabilities. That is the rule in all bankruptcy proceedings as far as liabilities are concerned. *It is not what* the bankrupt *owes but* what the property *brings* that finally settles the question of assets and liabilities, and balances the debit and the credit sides of the ledger. This via a discharge.

It then *provides* that *the farmer is* to remain in *possession for a period of three years* and pay the "usual and customary rental," on the *appraised* value, which rental is to be fixed by the court, and it provides further that if it

becomes necessary, to protect the creditors, the court may require additional payments, according to the *debtor's ability to pay* with a *view to his rehabilitation. Nowhere does the Act provide* that the District Court may shirk its duty and responsibility, and order the property sold.

Bartels Case.

In the *Bartels* case Justice Hughes says:

> "*The subsections of Section 75 which regulate the procedure in relation to the effort of a farmer-debtor to obtain a composition or extension contain no provision for a dismissal because of the absence of a reasonable probability of the financial rehabilitation of the debtor—nor is there anything in these subsections which warrants the imputation of lack of good faith to a farmer-debtor because of that plight. The plain purpose of Section 75 was to afford relief to such debtors who found themselves in economic distress however severe, by giving them the chance to seek an agreement with their creditors* (*subsections* (*a*) *to* (*r*)) *and, failing this, to ask for the other relief afforded by subsection* (*s*). The farmer-debtor may offer to pay what he can, as Bartels did, *and he is not to be charged with bad faith in taking the course for which the statute expressly provides.*" 60, S. Ct. 221.

Cannot Surrender Jurisdiction.

When a farmer-debtor comes into a Court of Bankruptcy, he comes into a Court of Equity. He *has a legal right* to ask for *a three year period* in which to refinance himself upon paying a reasonable rental and complying with other lawful orders of court. This *right* the District Court *may not deny him.* The court cannot escape the duties placed upon it by the Act.

> "For the court to afford the relief which the section as amended contemplates, it is necessary that the *exclusive* and *paramount jurisdiction* of the court *over* the

property of the bankrupt *be maintained;* and there can be no question but that the provisions of subsections (n) and (o) apply as well to proceedings continued under subsection (s) as to proceedings under the other provisions of section 75" *Bradford* v. *Fahey*, 76 F. (2d) 628 (C. C. A. 4th).

Section 75 (s).

This section seems to have been the stumbling block of some District Courts. *Every conceivable* attempt has been made *to destroy its effectiveness.* Yet, there is nothing new in this section. It simply applies old and well understood principles of law to Agriculture. These principles have been employed for years to industry under receiverships, trusteeships and bankruptcy. While this section has saved hundreds and thousands of homes *many more* could have been saved if all the District Courts had *entered into the spirit of the Act.*

In the *Bradford* case, 76 F. (2d) 628, Judge Parker of the Circuit Court of Appeals Fourth Circuit says:

> "As a matter of fact, no property in any real sense is taken from the lienholder by reason of the provisions of the act. The mortgaged property has already shrunk in value before the proceedings under the act are instituted; and the proceedings merely scale down the secured portion of the debt to the value of the encumbered property and transfer the lien of the encumbrance to the proceeds of that property when paid into court. While the lienholder is delayed in getting his money, the delay is probably not for so long a time, or the loss so great, as would result to him if the act were not passed and wholesale foreclosures of real estate mortgages should result."

In the *Radford* case, 8 F. Supp. 489, Judge Simon of the Circuit Court of Appeals Sixth Circuit says:

> "It is true that the appellant will not be able to collect the face value of its mortgages, nor the accrued

interest thereon. But this is a loss it has already sustained, not through the operation of the statute, but through the default, insolvency and bankruptcy of its debtor."

Has Equity in His Farm.

The fact is that Section 75 *gives every farmer*, who is insolvent or financially embarrassed, *a legal equity in his farm*. That equity *is the legal right to continue in possession* of his farm—live in his home—*for three years, provided he complies* with the orders of the court, *pays a reasonable rental*, and additional payments, if so ordered by the court. That equity gives him an opportunity to refinance and reestablish himself as a solvent rather than as an insolvent farmer.

That equity is analogous to the equity of redemption now existing in many States. In North Dakota and in other States the farmer has a period of one year in which to redeem from a mortgage foreclosure sale. During that year *he has a right of possession* and *is entitled to the rents and profits*. That is an equity that every creditor *must* and *does* respect. It is a *legal right* given to *every owner* of real estate.

No State or Federal Court *has ever* attempted to defeat the equity of redemption by holding that if the person's liabilities *exceed* his assets that then, he is *not entitled to possession and the right of redemption*. No court, either State or Federal, *has ever yet held* that the person who wishes to take advantage of the "equity of redemption" would have to *convince* the court, *in advance*, that he would *be able not only to redeem but to pay all* of his indebtedness. Such a decision would be considered absurd.

Equally absurd are the decisions that hold that under Section 75 a farmer *must show* that his assets *exceed* his liabilities, or else his farm will be ordered to be sold.

Doubly absurd are the decisions that hold that the farmer *must convince* the court, *three years in advance*, that he *will be able* to refinance himself at the end of three years, and *not only pay the market value* for his property *but all he owes*. Such a holding, whether deliberate or otherwise, annuls an Act of Congress, *not because* it is *unconstitutional but because of judicial legislation.* The Supreme Court of the United States *has never given* its approval to any such decisions. We are satisfied *it never will.*

Under Section 75, by expressed terms, the farmer has *a stay of proceeding, a right of possession*; that is similar to an equity of redemption for *three years.* This stay, of course, can be cut short if he fails to pay the reasonable rental, plus such additional payments as ordered by the court. The mere fact that the provisions of Section 75 *have been emasculated* by some District Courts *does not change the intent of Congress, or the language* of Section 75. We feel confident that the Supreme Court in this case *will once and for all* set these District Courts right.

The right that Section 75 gives to the farmer to remain in possession *for three years* upon paying a reasonable rental is a property right. It is an equity which Congress gave him. It does not depend upon judicial discretion. During that three years the farmer may refinance and rehabilitate himself financially. It was the *hope of Congress* and *it is the hope of the farmer* that during those three years *he might be able* to refinance and rehabilitate himself. That hope *no court may cut short* unless he fails to pay his rental or comply with the lawful orders of the court.

Adair v. *Bank of American National Trust & Savings Association* (Cal.), 303 U. S. 350;

First National Bank & Trust Company of Bridgeport, Connecticut, v. *Francis E. Beach*, 301 U. S. 435;

Wright v. *Union Central Life*, 304 U. S. 502.

Conclusion.

In conclusion we submit that the decision of the Circuit Court of Appeals of the Ninth Circuit in the case at bar is in conflict with the decision of the Circuit Court of Appeals of the Fifth Circuit in the *Bartels* case, which decision was confirmed by this court. The decision in the case at bar was rendered on December 2, 1939, two days before this Court confirmed the decision of the Circuit Court of the Fifth Circuit in the *Bartels* case. It is clearly in violation of the plain language of Section 75 (s) of the Bankruptcy Act and contrary to the decision of this Court in the *Bartels* case.

It is also contrary to the decision of this Court in the cases of *Leona Piatt Gray, and others*, v. *Union Joint Stock Land Bank of Detroit*, Nos. 365, 366 and 367, October Term, 1939, recently decided by this Court and in the cases of *Florence Morrison and Florence Morrison, Executrix* v. *The Federal Land Bank of Louisville, et al.*, Nos. 412 and 413, October Term, 1939. In these this Court reversed the Circuit Court of Appeals of the Sixth Circuit in the following manner:

> "*Per curiam:* The motions for leave to proceed *in forma pauperis* are granted.
>
> "The petitions for writs of certiorari are also granted, the judgments of the Circuit Court of Appeals are reversed, and the causes are remanded to the District Court for further proceedings.
>
> "See John Hancock Mutual Life Ins. Co. *v.* Benno Bartels, No. 33, decided December 4, 1939."

Respectfully submitted,

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